

FISCAL MEMORANDUM

HB 2354 – SB 2326

April 11, 2007

SUMMARY OF AMENDMENT (005823, 005976, 006040): Adds new language to the original bill requiring at least \$21.0 million of the new revenue generated by the cigarette excise tax increase be allocated to the Department of Agriculture, subject to annual appropriations by the General Assembly, to be used for farm programs administered by the Department of Agriculture. Changes the proposed tax increase to the cigarette excise tax from 40 cents to 20 cents per pack. Adds new language exempting bread and other essential food items from state sales tax.

FISCAL IMPACT OF ORIGINAL BILL:

Increase State Revenues - \$221,940,000 / General Fund
\$7,198,000 / Education Fund
\$41,000 / Department of Revenue
\$102,000 / Sinking Fund

(An amount equal to \$219,600,000 is included in the Governor's FY07-08 Budget Document)

Increase State Expenditures - \$200,000 One-Time
\$220,000 Recurring

Increase Local Govt. Revenues - \$4,062,000

FISCAL IMPACT OF BILL WITH PROPOSED AMENDMENTS:

Increase State Revenues – Net Impact - \$3,990,000

Increase State Expenditures –
\$21,000,000 Recurring – Department of Agriculture
\$220,000 Recurring – Department of Revenue
\$286,000 One-Time – Department of Revenue

Decrease Local Govt. Revenues – Net Impact - \$3,005,000

Other Fiscal Impact - An additional permissive decrease to local government revenues is estimated to be less than \$46,000,000. Any such decrease is dependent upon the number and extent of actions taken

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by local governing authorities to reduce or eliminate local option sales tax on bread or any of the essential food items identified in this bill.

Cigarette tax assumptions applied to amendments:

- According to the Department of Revenue (DOR), excise tax collections on cigarettes in FY05-06 were approximately \$115,462,000.
- Current excise tax rate on cigarettes is \$0.20 per pack.
- Estimated number of packs sold in FY05-06 was 577,310,000 ($\$115,462,000 \div \$0.20 = 577,310,000$ packs).
- Cigarette elasticity is estimated from a variable elasticity schedule depending upon the extent of any excise tax increase.
- Cigarette elasticity rate for proposed increase is estimated to be -0.115.
- Current state sales tax rate on cigarettes is 7.00%.
- Local option sales tax rate on cigarettes is estimated to average 2.25%.
- Current consumer price per pack is estimated to be \$3.19 per pack (excluding sales tax); \$3.49 per pack (including sales tax).
- Increasing the excise tax on cigarettes by \$0.20 per pack would also generate an additional \$0.02 per pack in state and local option sales tax revenue ($\$0.20 \times 9.25\% = \0.018).
- The total price increase to the consumer is estimated to be \$0.22 per pack ($\0.20 excise tax increase + $\$0.02$ incremental sales tax = $\$0.22$).
- Consumer price per pack after the proposed excise tax increase is estimated to be \$3.39 per pack (excluding sales tax); \$3.71 per pack (including sales tax).
- Increasing the excise tax on cigarettes would increase the price per pack to the consumer by an estimated 6.3% ($\$0.22 \div \$3.49 = 6.3\%$).
- Quantity demanded would decrease by an estimated 0.72% (6.3% price increase \times -0.115 elasticity rate = -0.72%).
- Quantity demanded in FY07-08 is estimated to be 573,153,368 packs ($577,310,000 \times \{100.00\% - 0.72\%\} = 573,153,368$).
- Total excise tax collections are estimated to be \$229,261,300 (573,153,368 packs \times \$0.40 excise tax = \$229,261,347) in FY07-08.
- Incremental excise tax collections are estimated to be \$113,800,000 ($\$229,261,300 - \$115,462,000 = \$113,799,300$) per year.
- Sales tax collections will increase because sales tax is computed on the final retail sale (which includes excise tax).
- Retail sales before the proposed excise tax increase are estimated to be \$1,841,619,000 (577,310,000 packs \times \$3.19 old price (excluding sales tax) = \$1,841,618,900).
- Retail sales after the proposed excise tax increase are estimated to be \$1,942,990,000 (573,153,368 packs \times \$3.39 new price (excluding sales tax) = \$1,942,989,918).
- Incremental retail sales are estimated to be \$101,371,000 ($\$1,942,990,000 - \$1,841,619,000 = \$101,371,000$).

- Incremental state sales tax revenue is estimated to be \$7,096,000 ($\$101,371,000 \times 7.00\%$ state rate = \$7,095,970) per year.
- The net recurring increase to state revenues resulting from incremental state sales tax collections is estimated to be \$6,770,000 ($\$7,096,000 - \$326,000$ local share = \$6,770,000) per year.
- The total net recurring increase to state revenues resulting from the increased excise tax is estimated to be \$120,570,000 ($\$113,800,000$ from additional excise tax + \$6,770,000 from additional sales tax = \$120,570,000) per year.
- Incremental local option sales tax revenue is estimated to be \$2,281,000 ($\$101,371,000 \times 2.25\%$ local option rate = \$2,280,847).
- The total net recurring increase to local government revenues resulting from the increased excise tax is estimated to be \$2,607,000 ($\$2,281,000$ in local option tax revenue + \$326,000 in state-shared sales tax revenue = \$2,607,000).

Food tax assumptions applied to amendments:

- According to the Department of Revenue (DOR), taxable sales of food and food ingredients in Tennessee for FY05-06 were approximately \$7,753,600,000.
- Based on historical collection patterns, taxable sales of food and food ingredients are estimated to grow by approximately 2.5% per year.
- Taxable sales for FY07-08 are estimated to be approximately \$8,146,126,000.
- Based from data obtained from the U.S. Department of Labor's Consumer Expenditure Survey and the U.S. Department of Agriculture's Special Supplemental Nutrition Program for Women, Infants, and Children, approximately 25.0% of all food and food ingredient expenditures are for items identified as essential food items.
- Taxable sales for bread and the essential food items in Tennessee for FY07-08 are estimated to be \$2,036,532,000 ($\$8,146,126,000 \times 25.0\% = \$2,036,531,500$).
- Current state sales tax rate on food and food ingredients is 6.0%.
- The decrease to state sales tax revenues is estimated to be \$122,192,000 ($\$2,036,532,000 \times 6.0\% = \$122,191,920$).
- Local governments are apportioned a 4.5925% share of state sales tax revenues.
- Local government revenues are estimated to decrease by \$5,612,000 from the loss of state-shared sales tax revenue ($\$122,192,000 \times 4.5925\%$ local share = \$5,611,667).
- The net decrease to state revenues is estimated to be \$116,580,000 ($\$122,192,000 - \$5,612,000$ local government share = \$116,580,000).
- The local option sales tax rate is estimated to average 2.25%.
- An additional permissive decrease to local government revenues is estimated to be less than \$46,000,000 per year ($\$2,036,532,000 \times 2.25\% = \$45,821,970$).

Other Assumptions applied to amendments:

- Revenues equal to \$219.6 million resulting from a proposed 40-cent increase to the cigarette excise tax has been included in the Governor's FY07-08 Budget Document.
- The overall net increase to state revenues is approximately \$3,990,000 (\$120,570,000 from increased revenues resulting from the change to the cigarette excise tax - \$116,580,000 in decreased revenues resulting from the elimination of sales tax on the specified food items = \$3,990,000).
- The overall net increase of \$3,990,000 is derived from (1) a net increase to the General Fund of \$80,394,000, (2) a decrease to the Education Fund of \$74,924,000, (3) a decrease to the Department of Revenue of \$423,000, and (4) a decrease to the Sinking Fund of \$1,057,000.
- The General Assembly allocates \$21,000,000 for farm program expenditures each year to be administered by the Department of Agriculture.
- Three additional Regulatory Officers in the DOR will be required to combat the illegal importation of cigarettes into Tennessee.
- Security upgrades will be required for cigarette tax stamps to combat illegal/counterfeit tax stamps.
- The recurring increase to state expenditures for the new positions and tax stamp enhancements is estimated to be \$220,000 per year.
- The one-time increase to state expenditures for computer and software enhancements and for costs associated with hiring the three Regulatory Officers is estimated to be \$286,000.

CERTIFICATION:

This is to duly certify that the information contained herein is true and correct to the best of my knowledge.



James W. White, Executive Director

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